

BEFORE THE FAIR POLITICAL PRACTICES COMMISSION

In the Matter of:)
)
Opinion requested by)
Gilbert E. Elmore,)
Administrative Law Judge)

No. 77-021
Jan. 27, 1978

BY THE COMMISSION: We have been asked the following questions by Administrative Law Judge Gilbert E. Elmore:

1. Does the term "investment" include sums withheld from salary by the State of California pursuant to the Public Employees' Retirement System plan and does the term "income" include earnings of such sums held for ultimate distribution after retirement?

2. Does the term "investment" include sums withheld from salary by the State of California pursuant to the various deferred compensation plan options and does the term "income" include earnings of such sums held for ultimate distribution after retirement.

CONCLUSION

1. Sums withheld pursuant to the Public Employees Retirement System are not "investments" and the earnings of such sums are not "income." Government Code Sections 82034, 82030.

2. Sums withheld pursuant to the various deferred compensation plans may be "investments" but the earnings of such sums are not "income."

ANALYSIS

1. Sums withheld from salary by the State of California pursuant to the Public Employees' Retirement System

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(PERS) plan are not "investments". The term "investment" is defined in Government Code Section 82034^{1/} to mean:

... [A]ny financial interest in or security issued by a business entity, including but not limited to common stock, preferred stock, rights, warrants, options, debt instruments and any partnership or other ownership interest,....

(Emphasis added.)

In order to have a reportable "investment," therefore, an official must have a financial interest in a business entity. It is questionable whether a state employee has a "financial interest" in a PERS plan since he holds no ownership interest in the plan, but only a right to retirement benefits on the basis of a statutorily prescribed formula. What the individual receives as a pension benefit is not dependent upon the financial success of the fund's investment policies. Therefore, there is little chance that a public official will be biased in his decisions because of the financial interests of the PERS fund.

Even if the employee's interest in PERS were a financial interest, however, it would not be an interest in a "business entity" within the meaning of the Act. "Business entity" is defined in Section 82005 to mean:

... any organization or enterprise operated for profit, including but not limited to a proprietorship, partnership, firm, business trust, joint venture, syndicate, corporation or association.

(Emphasis added.)

The PERS plan is a creature of state government. It is not a private entity operated for profit. We therefore conclude that employee withholdings to PERS are not investments within the meaning of the Act and are therefore not reportable.

With respect to income, the Political Reform Act specifically excludes from the definition of income, salary

^{1/} All statutory references are to the Government Code unless otherwise noted.

received from state or local government.^{2/} The Fair Political Practices Commission has held that such retirement or pension plans are simply a part of the employee's earnings package. See Opinion requested by Richard J. Moore, 3 FPPC Opinions 33 (No. 76-074, Mar. 1, 1977). More specifically, such plans are salary due and payable to the public employee, either upon vesting or upon retirement. Thus, the earnings of such retirement plans are a form of salary received from state or local government and are not "income."

2. Interests in the state-deferred compensation plan (DCP) may be "investments" within the meaning of the Political Reform Act. Although the state retains nominal ownership of funds invested through DCP, the employee determines the amount that he will invest in the plan and the form of the investment that will be made with his contribution. In addition, he has a contractual right to the return of his investment upon retirement, termination or emergency. The employee has a choice of investing in two mutual funds, two insurance company annuities or a savings account and may, if he so desires, change the investment vehicle in which his DCP funds are invested. In essence, the DCP is merely a means for deferral of federal income taxes on the funds invested in the plan. The employee exercises control over the nature and timing of his DCP investment and the financial benefit he receives will depend upon financial success of his investment decisions. Thus, for purposes of disclosure of economic interests, investments made through DCP should be treated as if the employee had received the salary and invested that money in the private investment vehicles offered by the DCP. Consequently, each of the five investment alternatives offered by DCP is an "investment" under Section 82034 of the Act unless otherwise excluded.

Section 82034 excludes insurance policies and time and demand deposits in a financial institution from the definition of investment. Thus, DCP holdings in annuities and savings bank deposits are not "investments" under the Act. On the other hand, an ownership interest in a mutual fund

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Section 82030(b)(2) provides:

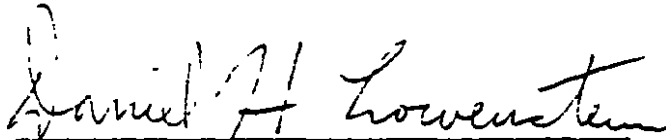
(b) "Income" also does not include:

(2) Salary and reimbursement for expenses or per diem received from a state or local government agency and reimbursement for travel expenses and per diem received from a bona fide educational, academic or charitable organization;....

is a "financial interest in or other security issued by a business entity" and is, therefore, an "investment" as defined in Section 82034. Thus, DCP holdings in the two mutual funds offered by the plan are "investments."

Notwithstanding the fact that interests in the DCP may be reportable "investments," income from those investments is not reportable. Section 82030(b)(7) specifically excludes interest, dividends and premiums from savings accounts and insurance policies from the definition of income. Consequently, the yield from DCP investments in annuities and savings accounts is not "income" under the Act. Moreover, dividends, interest or any other return on securities registered with the Securities and Exchange Commission are not "income." Section 82030(b)(8). Since the shares of the mutual funds offered by the DCP are SEC registered, the dividends or other return from these securities are not income under the Act.

Adopted by the Commission on January 27, 1978.
Concurring: Lowenstein, McAndrews and Remcho. Commissioners Lapan and Quinn dissented.


Daniel H. Lowenstein
Chairman

Commissioners Quinn and Lapan dissenting:

We dissent from the majority opinion which holds that sums withheld from a state employee's salary through "deferred compensation" programs and invested in mutual funds selected by the state are reportable "investments" within the meaning of the Political Reform Act.

These mutual fund investments should not be deemed reportable because, according to both the deferred compensation rules and state practice, these investments are state funds and not the property of the employee. Article X of the "DCP Plan" states:


The state shall have sole ownership of all investments made pursuant to this plan and no participant shall have any interests therein or the right to acquire the same.

We cannot see how this could be any clearer. There is no provision of the Political Reform Act which requires a filer to report investments which are not his. It is perfectly obvious that these funds remain the state's property, and do not pass to the employee until such time as the state sees fit to transfer them. The state rarely permits the employee to receive DCP funds until the employee retires or leaves state service. The employee has no right to withdraw funds from the DCP at will, and is entirely at the state's mercy if he wishes to take possession of his compensation prior to retirement.

Section 82030(b)(2) pointedly states that salary from the state or from local government is not reportable, and we recognized this in the opinion requested by Richard J. Moore, supra. That is what we are talking about here. Deferred compensation consists of state salary which the employee chooses to invest in one of five investment alternatives chosen for him by the state, in order to reduce his immediately taxable income. Were he not to participate in deferred compensation, and instead to take his monthly salary in a lump sum, we are all agreed that he would incur no reporting obligation at all.

Instead what he has done is refuse to take his salary now, preferring to allow the state to maintain ownership of it and invest it for him in the one of five specified entities he prefers. And yet, reasoning in a circuitous manner which defies all logic, the majority decides that under these circumstances, the salary-quia-investment is reportable.

The majority expresses concern that the mutual fund investment -- the only of the type of investments which is not specifically excluded from investments elsewhere in the Act -- might give rise to a conflict; and indeed it might, but so might many other things. The people solved this issue for us, however, by specifying that state salary, no matter what its form, is excluded from reporting, even though circumstances involving conflicts might arise in any number of instances. We should respect the people's determination that government salaries be exempt from reporting by reversing the decision reached by the majority in this opinion, and hold that a state salary, exempt from reporting in its original form, does not become reportable merely because the employee chose to defer payment by investing it in the deferred compensation plan.



T. Anthony Quinn
Commissioner